CME Group Inc. (CME)

Updated March 25th, 2020 by Samuel Smith

Key Metrics

Current Price:	$140	**5 Year CAGR Estimate:**	6.5%	**Market Cap:**	$56.8B
Fair Value Price:	$140	**5 Year Growth Estimate:**	4.3%	**Ex-Dividend Date:**	6/9/20[1]
% Fair Value:	100%	**5 Year Valuation Multiple Estimate:**	0.0%	**Dividend Payment Date:**	6/25/20[2]
Dividend Yield:	2.3%	**5 Year Price Target**	$173	**Years Of Dividend Growth:**	16
Dividend Risk Score:	C	**Retirement Suitability Score:**	F	**Last Dividend Increase:**	13.3%

Overview & Current Events

CME Group is a Chicago-based company that operates futures and derivatives exchanges based on interest rates, equities, currencies, and commodities. The company was founded in 1898, but didn't IPO until 2002. Since then, CME Group has pursued industry consolidation through mergers (CBOT Holdings) and acquisitions (Nymex Holdings). It currently generates about $5 billion in annual revenues and trades with a market capitalization of $57 billion.

CME Group reported fourth quarter earnings on February 12th. Adjusted earnings-per-share for the quarter came in at $1.52, down significantly from $1.77 in the year-ago period. Total quarterly revenue also declined sharply (7.9%) on declining daily volume (19%) as Q4 2018 saw a near bear market and lots of volatility with it. The few bright spots were that total average rate per contract increased by 3% sequentially to $0.717 and market data revenue increased, albeit very slightly, on a year-over-year basis.

Growth On A Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$2.86	$5.43	$2.70	$2.92	$3.35	$3.69	$4.53	$11.94	$5.71	$6.85	***$7.00***	***$8.63***
DPS	$0.92	$1.12	$1.79	$1.80	$1.88	$2.00	$2.40	$2.64	$2.80	$3.00	***$3.16***	***$4.39***
Shares[3]	332.0	334.0	332.0	334.0	336.0	338.0	339.0	340.0	344.0	162.8	***162.8***	***162.8***

Looking ahead we anticipate 4.3% average annual earnings per share growth over the next half decade. This is a material slowdown from the 8.5% annualized growth rate over the past decade, which we believe will result from the effect of the law of large numbers as well as its already significant industry consolidation, thereby limiting its growth runway. At the same time, we believe volatility in the public markets will remain strong for the foreseeable future as there remains enormous uncertainty on how various trade, geopolitical, global growth, and interest rate scenarios will play out to direct the near-term future of the American and global economies. Additionally, we expect CME to harvest significant synergies from its recent acquisition of Nymex Holdings, as their product offerings overlap nicely and enhance the overall competitive positioning of the firm. Finally, we see the company's extensive network and large volume as enabling it to drive growth through starting ancillary services and exchange products, as well as sell order flow data to third parties. As a result, we expect CME Group to continue growing earnings-per-share at a steady mid-single-digit clip for the foreseeable future.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	16.5	23.7	11.9	18.3	17.6	23.3	24.2	19.6	9.7	25.6	***20.0***	***20.0***
Avg. Yld.	2.2%	1.4%	1.7%	3.6%	3.5%	2.4%	2.2%	2.7%	2.3%	1.9%	***2.3%***	***2.5%***

CME Group's average price to earnings multiple of 20.4 over the past decade is right in line with where it is today, with the stock currently trading at 20.0 times expected 2019 earnings. We believe that, while the market is experiencing near

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[1] Estimate

[2] Estimate

[3] In millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

term expectations of continued increases in volatility to drive strong growth in earnings, over the next several years, growth will slow considerably. As a result, we are maintaining our fair value estimate and believe the stock is fairly valued at present.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	32.2%	20.6%	66.3%	61.6%	56.1%	54.2%	53.0%	22.1%	49.0%	45.0%	***45.1%***	***50.9%***

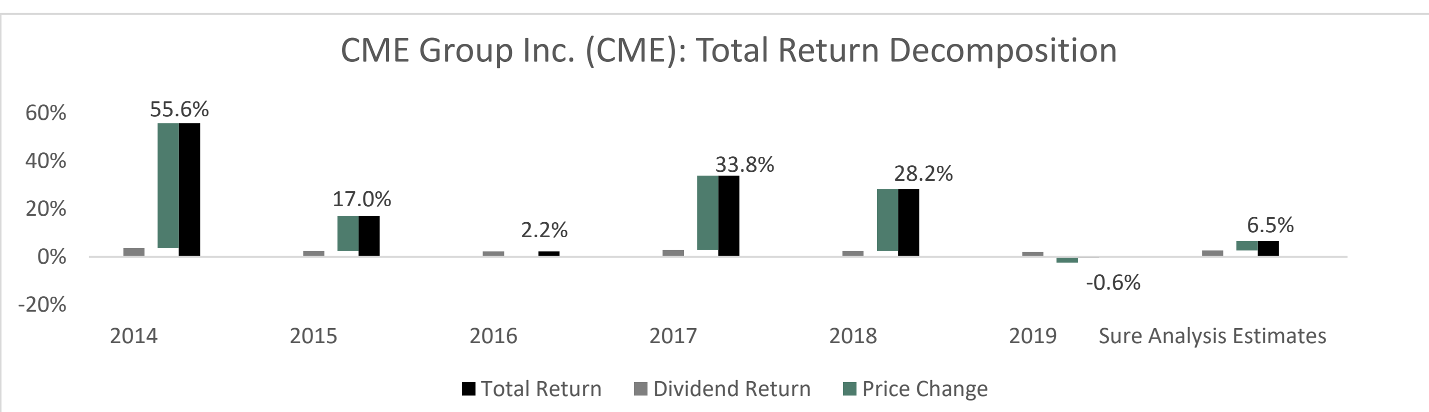
CME Group's biggest competitive advantage is its network effect as a consolidator in the financial exchange space. Thanks to its large volume, it offers customers considerable liquidity, which is an extremely attractive feature for this industry. The company's large volume also gives it economies of scale, enabling it to offer competitive pricing without considerably hurting profitability. This not only enables the company to retain customers, but also attracts new ones. As its customer count grows, its network effect only grows stronger, which in turn drives further liquidity and cost advantages, resulting in a virtuous cycle. Given that more than half of all interest rate-related futures in the world and nearly all North American interest rate-related futures are traded on the company's exchanges, it is clear that the company has established a dominant network effect in its core business.

While the company is not directly impacted by changes in stock market valuations, it did suffer during the last recession due to depressed market sentiment and customer bankruptcies, dramatically reducing activity on the exchanges. From peak to trough, CME Group's trailing twelve-month earnings per share fell from ~$3.45 in mid-2008 to $2.40 in mid-2009. The biggest long-term risk to the company is the potential for new regulation to disrupt the company's business model, which could break up its exchange and clearing operations or even limit the volatility on the exchanges or its pricing power. However, we do not see any threat developing in the near future, making the business fairly low-risk from a long-term perspective.

Final Thoughts & Recommendation

CME Group has grown considerably since its IPO 17 years ago thanks to industry consolidating mergers and acquisitions. Given its powerful network effect, we view it as a strong and stable company over the long-term. We also believe that volatility will continue to increase in the near-term, which will combine with continued acquisition synergy harvesting to sustain the exchange giant's earnings-per-share growth at a mid-single-digit clip over the next half decade. That being said, the company's dividend – while certainly safe and likely to continue growing given the current payout ratio – is not particularly attractive at just a 2.3% yield. Furthermore, the valuation is not a bargain either. As a result, we expect that CME Group will offer annualized total returns of 6.5% over the next half decade, prompting us to rate it a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	3004	3281	2915	2936	3113	3327	3595	3645	4309	4,868
Gross Profit	2363	2584	2200	2198	2341	2558	2810	2862	3354	3,594
Gross Margin	78.7%	78.8%	75.5%	74.9%	75.2%	76.9%	78.2%	78.5%	77.8%	73.8%
SG&A Exp.	158	162	160	176	211	216	136	146	171	172
D&A Exp.	258	261	253	238	233	229	225	209	249	473
Operating Profit	1831	2021	1692	1637	1768	1989	2201	2311	2608	2,588
Operating Margin	61.0%	61.6%	58.1%	55.8%	56.8%	59.8%	61.2%	63.4%	60.5%	53.2%
Net Profit	951	1812	896	977	1127	1247	1534	4063	1962	2,117
Net Margin	31.7%	55.2%	30.8%	33.3%	36.2%	37.5%	42.7%	112%	45.5%	43.5%
Free Cash Flow	1200	1174	1078	1155	1151	1418	1640	1669	2324	2,427
Income Tax	770	122	787	623	645	710	754	-1537	814	574

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	35046	40759	38863	54278	72242	67359	69369	75791	77476	75215
Cash & Equivalents	855	1042	1605	2470	1366	1693	1869	1904	1375	1,551
Accounts Receivable	298	289	268	303	341	358	364	360	553	492
Goodwill & Int. Ass.	28477	28337	27596	27486	27382	27282	27186	27091	33481	33036
Total Liabilities	14918	19207	17438	33117	51318	46808	49029	53379	51510	49056
Accounts Payable	52	31	42	36	37	29	26	31	116	62
Long-Term Debt	2525	2107	2857	2857	2108	2229	2231	2233	4401	3,743
Shareholder's Equity	20060	21552	21419	21155	20924	20552	20341	22412	25919	26129
D/E Ratio	0.13	0.10	0.13	0.14	0.10	0.11	0.11	0.10	0.17	0.14

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.7%	4.8%	2.3%	2.1%	1.8%	1.8%	2.2%	5.6%	2.6%	2.8%
Return on Equity	4.8%	8.7%	4.2%	4.6%	5.4%	6.0%	7.5%	19.0%	8.1%	8.1%
ROIC	4.3%	7.8%	3.7%	4.0%	4.8%	5.4%	6.8%	17.2%	7.1%	7.0%
Shares Out.	332.0	334.0	332.0	334.0	336.0	338.0	339.0	340.0	344.0	163
Revenue/Share	9.03	9.83	8.77	8.78	9.26	9.85	10.61	10.71	12.54	13.59
FCF/Share	3.61	3.52	3.24	3.45	3.42	4.20	4.84	4.91	6.76	6.78

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.